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A Practical Guide to Writing Environmental Disclosures

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Editors' Summary: An information-sharing arrangement with the U.S. Environmental Protection Agency gives teeth to the Securities and Exchange Commission's warning that companies that do not satisfy environmental disclosure requirements will be subject to enforcement actions. This Article provides companies a framework from which they can develop a strategy to meet those requirements. After briefly reviewing the relevant law, regulations, and guidance in this area, the authors offer insight into crafting and executing an effective environmental disclosure strategy.

About one-half of the staggering $185 billion taxpayers spend each year on government regulation, or about 2.5 percent of the gross national product, stems from environmental regulation.[1] Yet despite the magnitude of the cost and the pervasive effect of environmental issues on most U.S. corporations,[2] roughly 62 percent of the public companies responding to a recent PriceWaterhouse survey on corporate environmental practices conceded that they did not reflect known environmental problems in their financial reports.[3] This omission is particularly surprising since it follows nearly two years of relentless warnings by Commissioners of the Securities and Exchange Commission (SEC) and senior staffers at the SEC regarding impending enforcement actions against companies that have not adequately disclosed environmental liabilities and compliance costs.[4] An information-sharing arrangement with the U.S. Environmental Protection Agency (EPA) enables the SEC to evaluate the timeliness and adequacy of corporate environmental disclosures (or nondisclosures), and gives the SEC's admonitions real teeth.[5]

Properly assessing environmental issues and crafting ap-

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1. *See* E. DONALD ELLIOTT, ENVIRONMENTAL LAW AT A CROSSROAD (SEIBENTHAL LECTURE), *reprinted in* 20 N. KY. L. REV. 1 (1992) (citing Robert W. Hahn & John A. Hird, *The Costs and Benefits of Regulation: Review and Synthesis*, 8 YALE J. ON REG. 233, 271-72 (1991)).

2. Environmental issues have become like tax issues—they are a significant factor in every major business decision or transaction. *See* E. Donald Elliott, *Foreword, A New Style of Ecological Thinking in Environmental Law*, 26 WAKE FOREST L. REV. 1 (1991).

3. ACCOUNTING FOR ENVIRONMENTAL COMPLIANCE: CROSSROAD OF GAAP, ENGINEERING, AND GOVERNMENT: A SURVEY OF CORPORATE AMERICA'S ACCOUNTING FOR ENVIRONMENTAL COSTS, 10-11, PriceWaterhouse (1992).

4. *See, e.g.*, RICHARD Y. ROBERTS, ADDRESS TO THE DALLAS BAR ASS'N, ON THE SUBJECT OF RECENT DEVELOPMENTS CONCERNING ENVIRONMENTAL DISCLOSURE (May 28, 1992) [hereinafter ROBERTS, RECENT DEVELOPMENTS]; *Lawyer Advises Telling Firms to Present Balanced Financial Picture*, Sec. Reg. & L. Rep. (BNA) No. 18, May 7, 1993, at 662 (comments by Linda Quinn, Director of the SEC's Corporate Finance Division); *Schapiro, Fleischman Split on Whether SEC Will Bring More Administrative Cases*, Sec. Reg. & L. Rep. (BNA) No. 1, Mar. 15, 1991, at 401, 403 (comments by James Daly, Assistant Director of the SEC's Corporate Finance Division).

5. J. Stephen Shi & Susan H. Cooper, *SEC's Environmental Crackdown Forces Corporate Soul-Searching*, THE AMERICAN BANKER 12 (July 26, 1994) (explaining that EPA provides reports to the SEC that list companies named as potentially responsible parties at Superfund sites, as well as current criminal and civil enforcement actions brought under federal environmental laws, and uses SEC corporate information to aid its enforcement efforts, and that the SEC uses EPA to train personnel in environmental disclosure review); ROBERTS, RECENT DEVELOPMENTS, *supra* note 4, at 15-17; *IRS and Treasury May Share Info With SEC to Detect Fraud in Muni-Market*, SEC. WK. at 8 (McGraw-Hill, Inc.) (Mar. 9, 1992) (explaining that the SEC already has an information-sharing agreement with EPA, and that William McLucas, head of the SEC's Enforcement Division, is aiming to share information with other agencies).

   The SEC is considering formalizing the current training and information-sharing arrangement in a formal memorandum of understanding. Donald W. Stever & Eliza A. Dolin, *Corporate Counsel Focus on Corporate Compliance*, N.Y. L.J., Apr. 4, 1994, at S-3 (citing RICHARD Y. ROBERTS, ADDRESS ON THE SUBJECT OF ENVIRONMENTAL LIABILITY ACCOUNTING DEVELOPMENTS (June 10, 1993)).

   As a result of recent reorganization at EPA, enforcement staff levels have increased from approximately 300 to 850 persons. *SEC EPA Work on Agreement Regarding Exchange of Financial, Compliance Date*, Daily Env't Rep. (BNA) No. 194, Oct. 11, 1994, at A1. Under the Pollution Prevention Act of 1990, EPA has increased to over 150 the number of criminal investigators it employs to enforce felony offenses to over 150. 42 U.S.C. §13103, ELR STAT. PPA §13103.

propriate disclosures are challenging tasks that require a ombination of scientific, financial, and legal expertise. To neet the challenge, companies need a firm grasp of the relevant environmental disclosure standards and a well-planned strategy to meet those standards. This Article outlines the relevant standards and suggests ways for companies to proceed with the disclosure requirements. Because some of these standards are evolving, the Article first provides a brief review of the relevant law, regulations, and guidance in this area. The Article then offers insights into designing and implementing an effective environmental disclosure strategy. The authors recommend that as the SEC continues to heighten its scrutiny of environmental disclosures, companies should review and update, or design anew, procedures for reflecting environmental information in financial disclosures.

A Brief Primer on Legal Requirements for Environmental Disclosure

One or more of the following standards generally govern environmental disclosures.[6]

Regulation S-K Item 303—Management's Discussion and Analysis

While companies often are aware of the *existence* of potential environmental problems, their ability to assess confidently whether potential problems will in fact transpire, or to assess the *costs* that may be associated with such problems should they arise, is far more problematic. And, of course, if the actual assertion of liability is uncertain and the amount of any liability ultimately found to exist is unpredictable, the ability to divine whether any such liability, if asserted, would be material (and thus should be recorded in a company's financial statements) is virtually "impossible." In these circumstances, generally accepted accounting principles allow companies to refrain from quantifying a seemingly indeterminate potential liability.[7]

The SEC, however, has complicated matters by adopting Item 303 of Regulation S-K. Known as Management's Discussion and Analysis (MD&A), that item requires companies to discuss known trends, events, or uncertainties that are reasonably likely to have a material impact on the company's liquidity, capital resources, or operating results.[8] The discussion may be confined to information that is available to the company without undue effort or expense and that is not clearly reflected in the company's financial statements.[9] An important recent SEC administrative order, *In re Caterpillar, Inc.*,[10] which was one of the Commission's first *enforcement* foray into the MD&A arena, emphasizes the Commission's commitment to improve the quality of management's narrative disclosures of so-called soft information. Although that decision did not involve environmental disclosure issues, it is nonetheless instructive because it established several important premises that the SEC can be expected to apply to management's daunting task of crafting appropriate environmental disclosures.[11]

In 1989, three years before the *Caterpillar* order, the SEC issued an interpretive release on MD&A disclosures. The release suggested that disclosure of uncertainties *must* occur unless management is able to determine that a material effect on the company's financial condition or results is not "reasonably likely" to occur.[12] This "reasonably likely" standard has been interpreted as a less than 40 percent likelihood of occurrence.[13] To illustrate the application of MD&A standards, the SEC's 1989 release stated that disclosure would be required under the following circumstances:

> EPA correctly designates a company as a potentially responsible party under the Superfund law, no statutory defenses are available, and company management is unable to determine that a material effect on future financial condition or results is not reasonably likely to occur.[14]

Regulation S-K Item 101—Description of Business

Item 101 of Regulation S-K requires, among other things, disclosure of the material effects that compliance with federal, state, and local environmental laws and regulations may have on capital expenditures, earnings, or the competitive position of the company and its subsidiaries. Material estimated capital expenditures for pollution control must be disclosed for the current and succeeding fiscal years and future periods.[15]

The SEC's expectations in this area may be quite high. For example, SEC officials have noted that, despite the lack of EPA regulations implementing the maximum achievable control technology (MACT) standards under the Clean Air Act Amendments of 1990, EPA and, presumably, the SEC believe that companies know the cost of the best technology and can develop a worst-case estimate for compliance costs in most instances. Indeed, it has been suggested that EPA already has estimated the costs of compliance with the 1990 Amendments for each major industry.[16]

Regulation S-K Item 103—Legal Proceedings

Item 103 of Regulation S-K generally requires a brief description of material pending legal proceedings and such

6. For an excellent survey that covers many of the same issues as this section, see Margaret Murphy & Ottilie L. Jarmel, *SEC Poised to Crack Down on Environmental Accounting and Disclosure*, 5 ENVTL. CLAIMS J. 443 (Spring 1993).

7. *See* Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, Financial Accounting Standards Board, Mar. 1975, at 5-6 [hereinafter FASB 5].

8. 17 C.F.R. §229.303(a) (1993).

9. *Id.*, Instruction 2 to Item 303(a).

10. Sec. Exchange Act Rel. No. 30532, SEC LEXIS 786 (Mar. 31,

11. For a detailed analysis of the *Caterpillar* order, see Harvey L. Pitt et al., *MD&A Through the Eyes of Management: A Closer Look at the SEC's* Caterpillar *Decision*, 5 THE CORP. ANALYST 162 (Feb. 1993).

12. Sec. Act. Rel. No. 6835, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,436 at 62,145 and ¶ 73,193 at 62,842 (May 18, 1989).

13. The SEC Today, Vol. 91-51, at 112 (Mar. 15, 1991) (citing discussions with then SEC Commissioner Edward Fleischman).

14. Sec. Act. Rel. No. 6835, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,436 at 62,145 and ¶ 73,194 at 62,844 (May 18, 1989).

15. 17 C.F.R. §229.101(c)(xii) (1993). The issue of "materiality" is discussed *infra* at text accompanying notes 18-22.

16. ROBERTS, RECENT DEVELOPMENTS, *supra* note 4, at 3-4.

proceedings that governmental authorities are known to be contemplating.[17] "Ordinary routine litigation incidental to the business" of the filing company need not be described, although instruction 5 to Item 103 expressly excludes from the meaning of "ordinary routine litigation incidental to the business" legal proceedings arising under environmental laws or regulations. Instruction 5 requires disclosure of environmental legal proceedings:

- that are material to the company's business or financial condition;
- that involve a claim of damages or involve sanctions, capital expenditures, deferred charges, or charges to income in excess of 10 percent of current consolidated assets; or
- where the government is a party and any sanctions are reasonably expected to be $100,000 or more.

Materiality

Common to each of the SEC disclosure regulations discussed is the concept of materiality. Ever since the early 1970s, the question has been raised whether environmental issues deserve separate materiality standards more stringent than those applied to other disclosure items.[18] In a real sense, the SEC has modestly crossed that Rubicon by holding that environmental litigation that the government threatens may not be treated as "ordinary course of business" litigation, irrespective of the amounts in issue.[19] More pragmatically, there are mixed signals emanating from the SEC regarding the Commission's views on whether to move toward environmental disclosure standards that exceed standards based on economic materiality.

On the one hand, in commenting on the Government Accounting Office's (GAO's) recommendation that insurance companies routinely disclose certain information about all environmental claims whether or not the information would be material to an investor, SEC Commissioner Roberts stated that he is "more comfortable with the traditional Commission role of pressing for clear disclosure of all environmental information that is *economically* material to the issuer."[20] On the other hand, Commissioner Roberts has argued that current SEC disclosure standards "already [may] provide a basis for requiring disclosure of the GAO-desired information."[21] In discussing the materiality standard, Commissioner Roberts appears to recognize a continuum where "the greater the impact on financial statement line item amounts, the lower the level of qualitative factors necessary to warrant a finding that a reasonable investor would consider the [information] important."[22]

SFAS No. 5—Accounting for Contingencies

The Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 5 is critically important in ascertaining the extent to which environmental disclosures should be quantified on a company's financial statements. This Statement requires that a potential loss be reflected in the financial statements as a charge to income if the loss is both "probable" and "reasonably estimable."[23] Generally, if no charge to income is taken, footnote disclosure should reflect a loss that is at least reasonably possible.[24]

On June 8, 1993, the SEC released Staff Accounting Bulletin No. 92 (SAB No. 92), which interprets SFAS No. 5. In SAB No. 92, the SEC staff cautions companies that are potentially responsible parties (PRPs) at a Superfund site of the potential need to assess the financial strength or legal defenses of other PRPs at that site. Under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), courts have generally held PRPs jointly and severally liable for contamination because the contributions of the various PRPs to the contamination at most sites are indivisible,[25] although courts are able to apportion the costs of cleanup on a reasonable basis.[26] According to SAB No. 92, a PRP only needs to recognize liability with respect to its apportionment of the costs. The SEC staff, however, has made clear its view that "if it is

17. The description must include the name of the relevant court or agency, date initiated, principal parties, facts alleged, and relief sought. 17 C.F.R. §229.103 (1993).

18. *See* Theodore Sonde & Harvey L. Pitt, *Utilizing the Federal Securities Laws to "Clear the Air! Clean the Sky! Wash the Wind!,"* 16 How. L.J. 831 (1971). Much of the debate in the early 1970s centered on nature of the burden that the National Environmental Policy Act of 1969, 42 U.S.C. §§4321-4370d, ELR STAT. NEPA §§2-4370d, imposed on the SEC in connection with promulgating disclosure regulations. Ultimately, the District of Columbia Circuit Court of Appeals held that NEPA merely required the SEC to make "environmental considerations part of the SEC's substantive mission, [and not] . . . *require* the SEC to promulgate specific rules." Natural Resources Defense Council v. Securities Exchange Commission, 606 F.2d 1031, 1045, 9 ELR 20367, 20373 (D.C. Cir. 1979).

19. 17 C.F.R. §229.103 (1993).

20. RICHARD Y. ROBERTS, ADDRESS TO THE AMERICAN BAR ASS'N 1993 ANNUAL MEETING, ON THE SUBJECT OF ENVIRONMENTAL LIABILITY DISCLOSURE REQUIREMENTS, RECENT DEVELOPMENTS AND MATERIALITY, at 11 (Aug. 9, 1993) (emphasis supplied) [hereinafter ROBERTS, OVERVIEW OF ENVIRONMENTAL LIABILITY DISCLOSURE].

21. *Id.* at 12.

22. *Id.* at 16.

23. FASB 5, *supra* note 7, at 4-6. If the company can reasonably estimate the range of a probable loss within which no loss amount is more likely than another, the company must record the lower bound of the loss range. FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, Financial Accounting Standards Board, at 2 (Sept. 1976).

If the aggregate amount of the loss and timing of the payments due are reliably determinable, Emerging Issues Task Force of FASB, Issue 93-5, Financial Accounting Standards Board, at ¶ 6-16 (Mar. 16, 1993), the payments should be discounted by the "rate that will produce an amount at which the environmental . . . liability could be settled in an arm's-length transaction with a third party," or, if this rate is not determinable, "the interest rate on monetary assets that are essentially risk free and have maturities comparable to that of the environmental . . . liability." Securities and Exchange Commission, Staff Accounting Bulletin No. 92, at 9-10 (June 8, 1993) (footnotes omitted) [hereinafter SAB No. 92].

24. "If [footnote] disclosure is deemed necessary, the financial statements shall indicate the nature of the loss or loss contingency and give an estimate of the amount or range of loss or possible loss or state that such an estimate cannot be made." FASB 5, *supra* note 7, at 6.

25. *See, e.g.*, O'Neil v. Picillo, 682 F. Supp. 706, 724, 18 ELR 20893, 20902 (D.R.I. 1988), *aff'd*, 883 F.2d 176, 20 ELR 20115 (1st Cir. 1989), *cert. denied*, 493 U.S. 1071 (1990).

26. *See, e.g.*, United States v. Marisol, Inc., 725 F. Supp. 833, 842-43 (M.D. Pa. 1989) (recognizing that the volume and toxicity of waste disposed at the site by each party may form the basis for apportioning cleanup costs).

probable that other responsible parties will not fully pay costs apportioned to them," then the liability recognized should include the company's "best estimate" of the additional costs before considering its potential contribution claims.[27] Such additional costs that are reasonably possible should be disclosed in footnotes.[28]

Similarly, reporting companies that may rely on insurance to cover potential environmental liabilities, and that have thus far not reserved for such liability on the assumption that insurance coverage will render out-of-pocket costs to the company immaterial, have been warned to consider aspects of their insurance. For example, they should consider their insurers' financial viability and the success other companies have had in receiving reimbursement for similar insurance claims.[29] According to SAB No. 92, "the SEC Staff believes there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant."[30] This presumption is highly relevant in light of Commissioner Roberts' observation that the insurance industry is "fighting like mad" to contest the coverage of certain policies for certain environmental liabilities.[31] Under such circumstances, SAB No. 92 suggests that "offsetting"—the presentation of loss contingencies net of related claims for recovery—may be inappropriate. In determining whether or not to reserve for potential environmental liabilities, and whether or not to offset amounts anticipated from insurance coverage, issuers should do a thorough review of the bases of their claims, anticipated defenses to coverage that the company's insurer is likely to assert, the results of similar litigation, and the amounts in issue. Final conclusions should be reviewed with the company's independent auditors as well.

Key Lessons From Recent SEC Statements on Environmental Disclosures

Several important general lessons emerge from the SEC's developing views in this area:

- Narrative MD&A disclosure of uncertainties, including environmental uncertainties, may be required *whether or not* applicable accounting principles require a company to establish reserves for anticipated future costs of potential environmental liability.
- Public companies should develop meaningful internal procedures and mechanisms to ensure that the persons responsible for preparing periodic corporate filings with the SEC will receive prompt notice of material environmental information, including information provided to other government regulatory agencies and material uncertainties discerned or discussed in internal correspondence.
- Although the existence of appropriate procedures is a necessary component of disclosure compliance, it will not automatically suffice to protect a company against SEC enforcement action if the company's disclosures are deemed to be materially deficient notwithstanding the application of sound procedures.
- Information deemed appropriate for dissemination to senior management and/or members of a public company's board of directors is a starting point for any analysis regarding whether, to what extent, and when, information about environmental uncertainties may be required to be disclosed to the public. Not everything that is appropriate for dissemination to a company's senior management or board of directors, however, must be disclosed.
- In most cases, internal information will be sufficient to assess and support materiality and required disclosures. In some cases, however, it may be desirable to verify or supplement internal corporate assessments of environmental problems by obtaining reports from outside consulting firms with environmental expertise.
- In assessing materiality, companies should consider not only the traditional factors of financial implications for the company, but also evolving standards of concern about environmental issues and the nature of the disclosures other companies are making in similar circumstances.
- Sometimes it may be wise to disclose more than that which considerations of materiality strictly require. In those instances, providing a few carefully chosen details about an environmental issue may lay the matter to rest and avoid a difficult and potentially controversial decision about materiality.
- Absent special information about the claims payment policies of a particular insurer or particular jurisdiction, companies should not rely on the existence of insurance as essential support for a determination of nonmateriality (although they may mention it as an additional factor).

After assembling relevant information, verifying its sufficiency, and making initial judgments about what should be disclosed, companies must turn their attention to the fine art of writing disclosure statements, an art form as challenging in its own way as the haiku. In a disclosure statement, companies should thoroughly consider each detail and include each point with a specific purpose in mind, rather than as extraneous "general background." Companies should draft disclosures with the four general guideposts to effective disclosure in mind:

- tell the truth;
- tell the whole truth;
- tell the whole truth in plain English; and
- tell what the whole truth means.[32]

27. SAB No. 92, *supra* note 23, at 7.

28. *Id.*

29. ROBERTS, RECENT DEVELOPMENTS, *supra* note 4, at 13.

30. SAB No. 92, *supra* note 23, at 12 n.4.

31. ROBERTS, RECENT DEVELOPMENTS, *supra* note 4, at 13.7.

32. Mr. Pitt shared these guideposts at the 13th Annual Ray Garrett Jr. Corporate and Securities Law Institute Lectures, Corporate Counsel Center of Northwestern Law School, and Linda Quinn, Director of the SEC's Corporate Finance Division, remarked that "she expects to see a movement towards 'plainer English documents'—'plain English would be too much to hope for.'" *Lawyer Advises Telling Firms to Present Balanced Financial Picture*, Sec. Reg. & L. Rep. (BNA) No. 18, May 7, 1993, at 662.

Assessing the Risks and Developing an Adequate Disclosure Methodology

The following are offered as suggestions for companies to consider in developing an optimal process for environmental disclosures tailored to a particular company's situation and culture.

☐ *Target environmental problems as an important disclosure topic.* Given the current governmental preoccupation with environmental issues, both in terms of substantive violations of applicable local or national standards and potential financial consequences, most companies should consider adopting a *formal methodology* to ensure that they consider the need to make environmental disclosures on a quarterly and annual basis. For some companies, the process may be relatively simple, since the environmental consequences of their operations may be fairly well-understood. For others, particularly those in the mining, manufacturing, chemical, building, petroleum, pulp and paper, and insurance fields, detailed attention to environmental issues is critical. While it may not be necessary to make disclosures about environmental issues in every periodic filing, it surely will be necessary to consider whether to make such disclosures each quarter, and to document the bases for such decisions. By having a formal process, companies avoid overlooking the significant as well as underestimating the seemingly trivial, but potentially material, environmental consequences of various corporate activities.

☐ *Consider carefully the elements of a corporate environmental disclosure methodology.* While the components of a meaningful methodology will vary from company to company, some common elements would include:

- designating a senior officer to take responsibility and initiative for the environmental disclosure process;
- identifying and alerting the various sources of environmental information;
- requiring a check with persons and entities identified as sources of environmental information, to ensure that nothing significant has occurred; and
- reviewing internal memoranda to the board of directors or senior management regarding anticipated environmental expenditures and legal proceedings, as well as reports made to insurers and government agencies.

☐ *It is not only important to do the right thing, but also to be able to document that the company thought it was doing the right thing.* Developing a methodology for ascertaining whether environmental reporting is required is important, but once a methodology is developed it is critical that the company adhere to its stated policies and procedures. It is better not to adopt policies and procedures than to develop policies and procedures that the company does not effectively implement. The best way to ensure adherence to internal standards is to keep meticulous records, on a quarterly and an annual basis, of the efforts undertaken to develop data necessary to evaluate the need for environmental disclosures. Moreover, not every piece of information that is gathered in this type of process will necessarily warrant disclosure. After reviewing appropriate data, therefore, companies should back up documentation reflecting the disclosure determinations they made, the reasons for them, and the process the companies followed.

☐ *Maintain an outline or list of questions, issues, and documents that have been requested and received.* In developing such an outline or list of questions, companies should consider the relevant American Society for Testing and Materials (ASTM) standards regarding Phase I Environmental Site Assessments.[33] Although these ASTM standards primarily were designed to help satisfy the criteria for the "innocent landowner defense" to CERCLA, they suggest an investigative scope and process that many companies may find useful in designing their disclosure review strategies. If questions arise regarding the reasonableness of judgments made, a memorandum for the file that outlines the process followed, and a "laundry list" of the multiple factors considered in reaching judgments, may prove more useful in reconstructing the analysis in the future than a document that tries to reduce complex judgments to a single factor.

☐ *Monitor new developments and periodically reassess whether additional disclosures are required.* In addition to developing an effective methodology for obtaining important environmentally related corporate information, companies face serious obstacles in keeping current the wealth of data they collect. An excellent way to achieve currency is to perform follow-up interviews on the eve of filing whenever a significant period of time has elapsed since the initial data-gathering effort. In addition, several environmental software programs are available to manage information regarding hazardous substances and to generate environmental reports. Throughout the data-gathering effort, companies should pay particular attention to assuring that the positions they take in financial reporting are consistent with the statements the company makes in other venues, such as in correspondence with insurers or responses to government requests for information. The company that provides EPA with cost information about a particular pollution control technology in response to an information request will have some explaining to do to sustain a claim that the costs are too speculative to be quantified for financial reporting purposes.

☐ *Consider retaining outside environmental consultants to assist in the data-gathering, evaluation, and disclosure process.* Because environmental disclosure determinations frequently turn on highly technical issues, the independent expert judgment of an environmental consultant may be helpful in evaluating the technical significance or merits of a particular matter and in developing a sound range of risks based on technical uncertainties.[34] While clearly the exception rather than the rule, an evaluation by outside technical consultants can be helpful when the company's own internal information does not provide a sufficient basis for evaluating the magnitude of anticipated costs, or if issues arise concerning whether the

33. A copy of the ASTM standards can be obtained from the American Society for Testing and Materials, 1916 Race St., Philadelphia PA 19103.

34. The SEC staff has noted that environmental disclosure determinations often focus on complex technical issues that require concerted judgments by company employees, lawyers, and independent consultants. SAB No. 92, *supra* note 23.

company's methods are generally recognized as acceptable. Lawyers and underwriters should beware of passing on information without attempting to verify its accuracy if a knowledgeable person would question its accuracy.[35]

☐ *Environmental and securities counsel should consult with tax counsel regarding the tax treatment of environmental liabilities.* Companies should consider the tax implications of the costs associated with remediating environmental problems. One hotly debated issue is whether environmental remediation expenditures may be deducted or capitalized. At this time, at least two Internal Revenue Service (IRS) rulings suggest capitalization is required, many tax lawyers support deductibility, and the IRS has convened a working group to develop guidance on the appropriate tax treatment of at least 20 environmental scenarios.[36] In making disclosure decisions, environmental and securities counsel should consider anticipated and actual tax treatment of potentially discloseable environmental liabilities and, if disclosure is made, weigh disclosing past or future tax treatment of such liabilities.

☐ *Periodically review the prospective regulatory landscape and estimate the cost of future compliance.* Although Superfund issues present highly visible risks, companies should not overlook other environmental compliance issues. This is a particularly difficult area for some in-house environmental professionals, who are so busy complying with today's regulations they are not always fully cognizant of the regulatory developments that lie ahead. Since most environmental statutes contain deadlines that force future agency actions, however, future regulatory developments may be sufficiently predictable that they should be disclosed.[37] EPA's semiannual regulatory agenda is published in the *Federal Register* each April and October, and is an excellent source for keeping abreast of current and projected rulemaking efforts. For example, the Clean Air Act Amendments of 1990 will affect virtually every company in the United States. Those companies should focus on whether these predictable changes in the regulatory environment will have a material effect on their operations. In some instances, that a company will *not* be affected by upcoming regulations may also warrant disclosure.

☐ *Keep a close eye on the environmental and disclosure travails of competitors and other companies, and monitor your own performance against the difficulties that may beset others.* It is unfortunate, but axiomatic, that in this "Decade of Retribution,"[38] what befalls a company's competitors or colleagues may ultimately befall the company itself. There is no more effective way to predict future crises and difficulties than by looking at the crises and difficulties that afflict others and then reviewing appropriate measures of coming to grips with similar problems.[39]

☐ *Bear in mind that EPA and the SEC share data.* Although most companies already are aware that EPA provides the SEC with lists of PRPs, criminal and civil proceedings under environmental laws, and other information, they should also know that the information transfer is a two-way street. On occasion, the SEC staff refers environmental disclosure issues to EPA for its resolution, or inquires of EPA whether particular companies or industries may be vulnerable to environmental litigation. Given the two-way information transparency between the SEC and EPA, companies should avoid the dreaded disease of "cross-town estoppel," the phenomenon by which a company's filings or disclosures to two or more government regulators are somehow inconsistent. Particularly in connection with the development of estimates regarding the costs of various treatment, disposal, and other technologies, EPA obtains information from industry sources. Consequently, a company attempting to estimate the cost of environmental compliance for SEC disclosure purposes should ascertain whether it already has disclosed related information to EPA in response to Agency inquiries.

☐ *Consider designating a board committee to oversee the environmental compliance and disclosure process.* Given the renewed interest with which the government is evaluating company disclosures relating to the environment, it may be prudent, depending on a particular company's circumstances, size, and culture, to designate a committee of the board to monitor the company's compliance activities.

Deciding Whether and How to Disclose Environmental Information

☐ *The materiality of environmental issues should be judged from a quantitative perspective.* The determination of materiality often depends on the particular facts and circumstances surrounding a specific situation. It is, therefore, dangerous to assume that materiality can be reduced to simple quantitative formulae, to be applied unthinkingly in varying circumstances. Nonetheless, from a quantitative perspective, the SEC's staff frequently applies the following "rules of thumb":

- if the amount in issue is more than 10 percent of the number against which it is being measured, the amount is presumptively material;
- if the amount in issue ranges from 5 percent to 10 percent of the number against which it is being measured, the amount may, but often will not, be material; and, finally,
- if the amount in issue is less than 5 percent of the number against which it is being measured, the amount is presumptively not material.[40]

35. *See* Lincoln Savings & Loan Ass'n v. Wall, 743 F. Supp. 901, 919-20 (D.D.C. 1990) (expressing outrage that the overreaching activities of Charles Keating occurred despite the involvement of scores of accounting and legal professionals, District Court Judge Stanley Sporkin asked, "where were [the] professionals?").

36. Marianne Lavelle, *Deductions Mulled for Environmental Cleanup Expenses*, NAT'L L.J., Dec. 20, 1993, at 15.

37. *See* discussion *supra* accompanying note 16. It should be noted, however, that there are substantial sources of discretion available to EPA. *See* E. DONALD ELLIOTT & E. MICHAEL THOMAS, SUSTAINABLE ENVIRONMENTAL LAW 1257, 1285-87 (Celia Campbell-Mohn et al. eds., 1993) (referring to EPA's discretion in defining the nature of the "source" subject to MACT standards).

38. Harvey L. Pitt & Karl A. Groskaufmanis, *Mischief Afoot: The Need for Incentives to Control Corporate Criminal Conduct*, 71 B.U. L. REV. 447 (Mar. 1991).

39. Harvey L. Pitt & Karl A. Groskaufmanis, *When Bad Things Happen to Good Companies: A Crisis Management Primer*, 22 THE LAW BRIEF 2 (Nov. 30, 1992).

40. ROBERTS, OVERVIEW OF ENVIRONMENTAL LIABILITY DISCLOSURE *supra* note 20, at 15.

☐ *Notwithstanding the lack of quantitative materiality in any situation, companies should also consider the qualitative materiality of a particular set of facts or occurrences.* Qualitative materiality is a more difficult concept, and one in which there is less than adequate guidance from the Commission. Nonetheless, companies should bear in mind that the SEC staff is likely to consider it material that senior management or a company engaged in multiple, or intentional, violations or alleged violations of law, even if the financial impact of those violations does not comport with the quantitative "rules of thumb." And the SEC has indicated that its view, or at least some of its members' view, of qualitative materiality in the field of environmental disclosure may be expanding. In particular, Commissioner Roberts has stated that "[i]llegal acts . . . may not qualify as material from a quantitative perspective, but would likely be material to an investor, who is entitled to assume a market free from such acts."[41]

While it is not precise or scientific, the current preoccupation with environmental matters, combined with the heavy investor interest in mutual funds (and other investment vehicles) that specialize in environmentally sound portfolio companies, will enhance the ability of the government or shareholders to argue that a particular environmentally related matter is material. Accordingly, in addition to looking at our quantitative "rules of thumb," and the surrounding facts and circumstances, companies should also consider the prevailing climate, both nationally and internationally, and as it relates to the particular industries in which the reporting companies operate.

☐ *Analyze potential insurance recoveries and contribution claims separately and consider the materiality of such recoveries.* As noted above, there are a number of critical components to the disclosure of environmentally related information. First and foremost is the company's individual exposure to claims of environmental defalcation. The extent to which a company's activities are governed by various environmental protection statutes, the nature of the company's operations, and the impact on the manner and method of doing business that applicable regulations create, are also relevant in the disclosure process. But by no means does that exhaust the level of inquiry that should be undertaken. Companies should also consider the extent to which they are relying on insurance coverage or contribution claims (including claims against solvent potential codefendants) as a means of concluding that they do not have any material environmental exposure. Given the current condition of the economy and the fact that many insurers and potential codefendants deny liability, or an obligation to reimburse or indemnify, companies should carefully evaluate whether, in the absence of insurance coverage or contribution, they would have a materially discloseable event. If they would have such an event, companies should then carefully assess the likelihood of recovery from other sources before concluding that disclosure is not required.

☐ *As is true of all areas of disclosure, while companies are encouraged to be forthcoming, they should also bear in mind that more disclosure may sometimes prove less informative.* Environmental disclosures should be crafted with an eye for the appropriate level of detail. Because of the technical and scientific nature of many environmentally related issues, care should be taken to avoid excessive detail that may detract from clarity and precision. On the other hand, companies should be mindful that a thorough discussion of complex material environmental effects may enhance management's credibility and provide needed support for judgments that certain facts are not material and should not be disclosed.

Conclusion

Over the past two years there have been many warnings regarding the likelihood of future SEC enforcement action. The only clear message emanating from the Commission is that, at worst, the standards are unclear and, at best, the standards are clear until they are applied to a particular set of facts. According to SAB No. 92, the

> [s]taff believes that product and environmental liabilities *typically* are of such significance that *detailed disclosures regarding the judgments and assumptions* underlying the recognition and measurement of the liabilities are necessary to prevent the financial statements from being misleading and to inform readers fully regarding the *range of reasonably possible outcomes* that could have a material effect on the registrant's financial condition, results of operations, or liquidity.[42]

In the current environment of greater government scrutiny of environmental conduct and retribution for violations of normative behavioral standards, it is prudent to take appropriate steps to avoid being the precedent-setting guinea pig for the SEC's Enforcement Division. Publicly held companies should develop a compliance strategy designed to foster the systematic assessment and, potentially, disclosure of key environmental issues.

41. *Id.* at 13.

42. SAB No. 92, *supra* note 23, at 11 (emphasis added).